Top Ten Developments in Agricultural Law and Taxation in 2023-Part 5 California's Proposition 12 and the U.S. Supreme Court

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Overview

Today's article is fifth in a series concerning the Top Ten ag law and tax developments of 2023. To recap, here's the list of the top developments so far:

- 10 - Court orders removal of wind farm.
- 9 – Reporting Rules for Foreign Bank Accounts
- 8 – New Business Information Reporting Requirements
- 7 – "Renewable" Fuel Tax Scam
- 6 – Limited Partners and Self-Employment Tax
- 5 – COE Mismanagement of Missouri River Water Levels
- 4 – The Employee Retention Credit

That brings me to the third most important development in ag law and tax of 2023 – it's the topic of today's post.

California's Proposition 12 at the U.S. Supreme Court

North American Meat Institute v. Bonta, 141 S. Ct. 2854 (2021)

In a huge blow to pork producers (and consumers of pork products) nationwide, the Supreme Court of the United States (Court) upheld California's Proposition 12 against a constitutional challenge. Proposition 12 requires any pork sold in California to be raised in accordance with California's housing requirements for hogs. This means that U.S. hog producers must ensure that their production facilities satisfy California's requirements for the resulting pork products to be sold to California consumers.

Involved in the case was a claim involving the judicially created doctrine known as the "dormant Commerce Clause." A bit of background is in order.

The Commerce Clause. Article I Section 8 of the U.S. Constitution provides in part, "the Congress shall have Power…To regulate Commerce with foreign Nations and among the several states, and with the Indian Tribes." The Commerce Clause, on its face, does not impose any restrictions on states in the absence of congressional action. However, the U.S. Supreme Court has interpreted the Commerce Clause as implicitly preempting state laws that regulate commerce in a manner that disrupts the national economy. This is the judicially created doctrine known as the "dormant" Commerce Clause.

The "dormant" Commerce Clause. The dormant Commerce Clause is a constitutional law doctrine (that is not in the text of the Constitution) that says Congress's power to "regulate Commerce … among the several States" implicitly restricts state power over the same area. In general, the Commerce Clause places two main restrictions on state power – (1) Congress can preempt state law merely by exercising its Commerce Clause power by means of the Supremacy Clause of Article VI, Clause 2 of the Constitution; and (2) the Commerce Clause itself--absent action by Congress--restricts state power. In other words, the grant of federal power implies a corresponding restriction of state power. This second limitation has come to be known as the "dormant" Commerce Clause because it restricts state power even though Congress's commerce power lies dormant. *Willson v. Black Bird Creek Marsh Co., 27 U.S. 245 (1829).* The label of "dormant Commerce Clause" is really not accurate – the doctrine applies when the *Congress* is dormant, not the Commerce Clause itself.

The rationale behind the Commerce Clause is to protect the national economic market from opportunistic behavior by the states - to identify protectionist actions by state governments that are hostile to other states. Generally, the dormant Commerce Clause doctrine prohibits states from unduly interfering with interstate commerce. State regulations cannot intentionally discriminate against interstate commerce. If they do, the regulations are per se invalid. *See, e.g., City of Philadelphia v. New Jersey, 437 U.S. 617 (1978).* Also, state regulations cannot impose undue burdens on interstate commerce. *See, e.g., Kassel v. Consolidated Freightways Corp., 450 U.S. 662 (1981).* Under the "undue burden" test, state laws that regulate evenhandedly to effectuate a local public interest are upheld unless the burden imposed on commerce is clearly excessive in relation to the local benefits.

The Court has never held that discrimination between in-state and out-of-state commerce, without more, violates the dormant Commerce Clause. Instead, the Court has explained that the dormant Commerce Clause is concerned with state laws that both discriminate between in-state and out-of-state actors that compete with one another, *and* harm the welfare of the national economy. Thus, a discriminatory state law that harms the national economy is permissible if in-state and out-of-state commerce do not compete. *See, e.g., General Motors Corp. v. Tracy, 117 S. Ct. 811, 824-26 (1997).* Conversely, a state law that discriminates between in-state and out-of-state competitors is permissible if it does not harm the national economy. *H.P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525 (1949).*

Proposition 12. In 2018, California voters passed Proposition 12. Proposition 12 bans the sale of whole pork meat (no matter where produced) from animals confined in a manner inconsistent with California's regulatory standards. Proposition 12 established minimum requirements on farmers to provide more space for egg-laying hens, breeding pigs, and calves raised for veal. Specifically, the law requires that covered animals be housed in confinement systems that comply with specific standards for freedom of movement, cage-free design, and minimum floor space. The law identifies covered animals to include veal calves, breeding pigs and egg-laying hens. The implementing regulations prohibit a farm owner or operator from knowingly causing any covered animal to be confined in a cruel manner, as specified, and prohibits a business owner or operator from knowingly engaging in the sale within the state of shell eggs, liquid eggs, whole pork meat or whole veal meat, as defined, from animals housed in a "cruel manner." In addition to general requirements that prohibit animals from

being confined in a manner that prevents lying down, standing up, fully extending limbs, or turning around freely, the measure added detailed confinement space standards for farms subject to the law. The alleged reason for the law was to protect the health and safety of California consumers and decrease the risk of foodborne illness and the negative fiscal impact on California.

In late 2019, several national farm organizations challenged Proposition 12 and sought a declaratory judgment that the law was unconstitutional under the dormant Commerce Clause. The plaintiffs also sought a permanent injunction preventing Proposition 12 from taking effect. The plaintiffs claimed that Proposition 12 impermissibly regulated out-of-state conduct by compelling non-California producers to change their operations to meet California's standards. The plaintiffs also alleged that Proposition 12 imposed excessive burdens on interstate commerce without advancing any legitimate local interest by significantly increasing operation costs without any connection to human health or foodborne illness. The trial court dismissed the plaintiffs' complaint. *National Pork Producers Council, et al. v. Ross, 456 F. Supp. 3d 1201 (S.D. Cal. 2020).*

On appeal, the plaintiffs focused their argument on the allegation that Proposition 12 has an impermissible extraterritorial effect of regulating prices in other states and, as such, is per se unconstitutional. This was a tactical mistake for the plaintiffs. The appellate court noted that existing Supreme Court precedent on the extraterritorial principle applied only to state laws that are "price control or price affirmation statutes." *National Pork Producers Council, et al. v. Ross, 6 F.4th 1021 (9th Cir. 2021).* Thus, the extraterritorial principle does not apply to a state law that does not dictate the price of a product and does not tie the price of its in-state products to out-of-state prices. Because Proposition 12 was neither a price control nor a price-affirmation statute (it didn't dictate the price of pork products or tie the price of pork products sold in California to out-of-state prices) the law didn't have the extraterritorial effect of regulating prices in other states.

The appellate court likewise rejected the plaintiffs' claim that Proposition 12 has an impermissible indirect "practical effect" on how pork is produced and sold outside California. *Id.* Upstream effects (e.g., higher production costs in other states) the appellate court concluded, do not violate the dormant Commerce Clause. The appellate court pointed out that a state law is not impermissibly extraterritorial unless it regulates conduct that is wholly out of state. *Id.* Because Proposition 12 applied to California and non-California pork production the higher cost of production was not an impermissible effect on interstate commerce.

The appellate court also concluded that inconsistent regulation from state-to-state was permissible because the plaintiffs had failed to show a compelling need for national uniformity in regulation at the state level. *Id.* In addition, the appellate court noted that the plaintiffs had not alleged that Proposition 12 had a discriminatory effect on interstate commerce.

Simply put, the appellate court rejected the plaintiffs' challenge to Proposition 12 because a law that increases compliance costs (projected at a 9.2 percent increase in production costs that would be passed on to consumers) is not a substantial burden on interstate commerce in violation of the dormant Commerce Clause.

U.S. Supreme Court

On May 11, 2023, the Court issued a 5-4 plurality opinion dismissing the case for failure to state a claim. While the Court did not address the merits of the case, the Court did issue a total of five opinions (including a dissent) that can provide guidance for future cases alleging a dormant commerce clause violation.

Plurality opinion. The controlling plurality opinion (Justices Gorsuch, Thomas, Barrett, Sotomayor and Kagan) pointed out that the Congress has the power to regulate interstate commerce (Article I, Section 8), but hadn't enacted any statute that would displace Proposition 12. So, the Court noted, the pork producers were claiming that the dormant Commerce Clause should be utilized to negate Proposition 12. As noted, the pork producers didn't allege any purposeful discrimination by California, instead relying on the "extraterritoriality doctrine," with the result that, because price discrimination was not involved, the Court rejected adopting a "per se" rule under the dormant Commerce Clause that would strike down state legislation that only has an impact beyond that state's borders. Indeed, the Court said, "This argument falters out of the gate."

The fallback argument of balancing under *Pike v. Bruce Church, Inc., 397 U.S. 137 (1970)* was rejected by Justices Gorsuch, Thomas and Barrett on the basis that balancing state interests was a policy decision to be left up to the Congress.

Note: In *Pike*, the Court held that the power of the states to enact laws that interfere with interstate commerce is limited when the law poses and *undue burden* on business transactions. "Undue burden is to be determined based on a balancing test which depends on the facts of each particular situation.

Indeed, Justice Barrett concluded that the benefits and burdens of Proposition 12 were impossible to measure, but that the complaint plausibly alleged a substantial burden on interstate commerce that would be felt almost exclusively outside California. Justices Sotomayor and Kagan would have engaged in balancing but because the pork producers failed to plausibly allege a substantial burden on interstate commerce (which is a requirement under *Pike)*, the Court said it had no way to weigh the costs of Proposition 12 against California's "moral and health interests." Again, the Court said the matter was a policy choice to be left up to the Congress and that the Commerce Clause does not protect a particular structure or method of business operation – "That goes for pigs no less than gas stations."

Dissenting opinion. Chief Justice Roberts wrote a dissenting opinion that was joined by Justices Alito, Kavanaugh and Jackson. The dissent concluded that a substantial burden on interstate commerce was present because Proposition 12 impacted practically the entire U.S. hog industry due to the interconnected nature of the nationwide pork industry which would require the compliance of the vast majority of hog producers. It was more than a cost of compliance issue. The question was then, in the words of the dissent, whether the burden of Proposition 12 was clearly excessive in relation to the "putative local benefits." This determination needed to be made by the lower courts, the dissent argued.

Separate opinion. Justice Kavanaugh wrote separately to point out that California was regulating hog production in other states and that other states had good reason for allowing hogs to be raised in a manner the California found offensive. He also noted that it would be virtually impossible for hog farmers and pork processors to segregate individual hogs based on their ultimate destination, and that each state has its own rules for health and safety as applied to hog production. Justice Kavanaugh stated, "California's approach undermines federalism and the authority of individual States by forcing individuals and businesses in one State to conduct their farming, manufacturing and production practices in a manner required by the laws of a different State." If Proposition 12 were to be upheld, a "blueprint" could be provided for other states. Justice Kavanaugh also stated that California's approach could also be challenged under the Privileges and Immunities Clause, the Import-Export Clause and the Full Faith and Credit Clause. He concluded with a biting criticism of the lawyers for the pork producers by stating, "It appears, therefore, that properly pled dormant Commerce Clause challenges under Pike to laws like California's Proposition 12 (or even to Proposition 12 itself) could succeed in the future – or at least survive past the motion-to-dismiss stage."

Conclusion

Historically, the Court has been careless in applying the anti-discrimination test, and in many cases, neither of the two requirements--interstate competition or harm to the national economy--is ever mentioned. *See, e.g., Hughes v. Oklahoma, 441 U.S. 322 (1979).* The reason interstate competition goes unstated is obvious – in most cases the in-state and out-of-state actors compete in the same market. But, the reason that the second requirement, harm to the national economy, goes unstated is because the Court simply assumes the issue away.

Implications. The dormant Commerce Clause is something to watch for in court opinions involving agriculture. As states enact legislation designed to protect the economic interests of agricultural producers in their states, those opposed to such laws could challenge them on dormant Commerce Clause grounds. But such cases must be plead carefully to show an impermissible regulation of extraterritorial conduct.

In the present case, practically doubling the cost of creating hog barns to comply with the California standards was not enough, nor was the interconnected nature of the pork industry. California gets to call the shots concerning the manner of U.S. pork production for pork marketed in the state. This, despite overarching federal food, health and safety regulations that address California's purported rationale for Proposition 12.

Clearly a majority of the Justices said such matters as Proposition 12 is up to the Congress. On that point, since 2015 legislation has been introduced in the U.S. House on multiple occasions to address interstate commerce cannibalization by a state. On two occasions, the legislation passed the House but only to die in the U.S. Senate and not get included in a Farm Bill. The legislation, was entitled the "Protect Interstate Commerce Act" and would have barred a state from imposing a standard or condition on the production or manufacture of agricultural products sold or offered for sale in interstate commerce if (1) the production or manufacture occurs in another state, and (2) the standard or condition adds to standards or conditions applicable under Federal law and the laws of the state in

which the production or manufacture occurs. More recently, the legislation was later introduced in the U.S. Senate under a different title.

Note: Certainly, congressional action can resolve questions about the constitutionality of agricultural regulations under the Commerce Clause. For example, a Vermont "genetically modified organism" labelling law was challenged through litigation, but Congress reached a nationwide solution by creating a uniform national standard. In the current situation, The Congress could set a specific standard for cage sizes that preempts state laws or, as the proposed legislation attempts, set a general rule for state regulation of products in interstate commerce.

The dormant commerce clause is one of those legal theories "floating" around out there that can have a real impact in the lives of farmers, ranchers and consumers, and how economic activity is conducted. But a case challenging a state law on dormant Commerce Clause grounds must be plead and argued properly for a court to hear it. That didn't happen in the present situation.